



MINUTES

Motor Vehicle Fuel Study Committee

November 4, 2005

MEMBERS PRESENT:

Senator Jerry Behn, Co-chairperson
Senator John P. Kibbie, Co-chairperson
Senator Daryl Beall
Senator Steve Kettering

Representative Jack Drake, Co-chairperson
Representative Bob Kressig
Representative Linda Upmeyer

MEETING IN BRIEF

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- I. Procedural Business.
- II. Opening Statements.
- III. Petroleum Marketers and Convenience Stores of Iowa.
- IV. Attorney General's Office.
- V. Department of Agriculture and Land Stewardship.
- VI. Hy-Vee, Inc.
- VII. Dyno Oil Company, Inc.
- VIII. Iowa Grocery Industry Association.
- IX. American Petroleum Institute.
- X. Casey's General Stores, Inc.
- XI. Petroleum Marketers and Convenience Stores of Iowa.
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I. Procedural Business.

Call to Order. Co-chairpersons Drake and Kibbie called the Committee meeting to order at 10:00 a.m. on Friday, November 4, 2005, in Room 116 of the State Capitol.

Election of Co-chairpersons. Representative Upmeyer moved that the temporary Co-chairpersons be elected permanent Co-chairpersons. The motion was seconded by Senator Beall and the motion was adopted by unanimous consent.

Adoption of Rules. Co-chairperson Drake moved that the proposed rules be adopted as the Committee's rules. The motion was adopted by unanimous consent.

Adjournment. The Committee recessed for lunch at 12:00 p.m. and reconvened at 1:05 p.m. The Committee adjourned at 3:15 p.m.

II. Opening Statements.

Co-chairpersons Drake, Kibbie, and Behn thanked members, staff, participants, and audience members for attending the meeting and contributing to the process. Co-chairperson Drake invited members, staff, and audience members to introduce themselves. He stated that the charge of the meeting was to investigate issues relating to the sale of motor vehicle fuel, including minimum markup, selling below cost, and limited quantities of gasoline.

III. Petroleum Marketers and Convenience Stores of Iowa.

Testimony. The Committee considered testimony by Ms. Dawn Carlson, President of the Petroleum Marketers and Convenience Stores of Iowa (PMCSI). Ms. Carlson stated that there are 2,735 retail outlets marketing motor fuel and that PMCSI is a trade association representing over 800 small businesses with nearly 2,000 motor fuel retail outlets.

Ms. Carlson briefly discussed retail motor fuel pricing practices. She stressed that PMCSI member businesses are not owned by major petroleum companies but are their customers. She described how contracts govern pricing decisions made by motor fuel retailers, the factors governing how gasoline is priced on a wholesale and retail basis, and how gasoline is transported to Iowa. She also briefly discussed how recent hurricanes in the southern United States have temporarily reduced the supply of refined petroleum products such as motor fuel. Ms. Carlson noted that a number of factors affect retail pricing of motor fuel, including natural disasters, federal regulations, credit card fees, and the need to manufacture different types of motor fuel for different markets in the country. According to Ms. Carlson, the most significant factor affecting the day-to-day retail pricing decisions is product replacement costs (i.e., retailers must set prices at a level that will permit them to generate sufficient revenue to replace motor fuel inventories). She provided the Committee with a brief summary of other states' motor fuels fair marketing laws.

Ms. Carlson informed the Committee that Iowa has one of the lowest average retail profit margins in the country, which has resulted in a large number of retail outlet closings and transfers. She stated that there have been over 100 closings within the last few years due to low profit margins and the increased consolidation of retail businesses in the marketplace. She recommended that the General Assembly consider policies to encourage the continuation of small independent businesses in rural regions of the state.



Ms. Carlson briefly discussed legislative proposals mandating the use of conventional ethanol blended gasoline (E-10 gasoline) and proposals to increase the supply of high ethanol blend gasoline (E-85 gasoline). She expressed support for measures which encourage the increased consumption of E-10 gasoline (e.g., income tax credits), noting that PMCSI members have actively promoted the sale of E-10 gasoline even when its wholesale price was not competitive with conventional gasoline. Ms. Carlson concluded that in Iowa, 80 percent of all gasoline sales are E-10 gasoline. She recommended that statutes be enacted which would allow petroleum marketers to purchase alcohol from producers (ethanol plants).

Discussion. Committee members and Ms. Carlson discussed a number of issues. In response to questions, Ms. Carlson commented that PMCSI does not take a position regarding below-market pricing practices. In response to a question by Senator Kettering, she noted that 95 percent of the price charged by retail dealers is determined by prices established by wholesale distributors. She also addressed issues involving the increasing number of flexible fuel automobiles and challenges present in installing the infrastructure necessary to offer E-85 gasoline, including government regulations, the development of necessary technical standards, and contract restrictions imposed on retail dealers by wholesale distributors. Senator Beall and Ms. Carlson discussed factors which affect pricing in different areas of the state, including property taxes, the proximity of terminals, and the number of competitors in the market.

IV. Attorney General's Office.

Testimony. The Committee considered testimony by Mr. William Brauch, Special Assistant Attorney General, Director, Consumer Protection Division. Mr. Brauch stated that the office has received a number of complaints from consumers questioning high retail gasoline prices since Hurricane Katrina devastated the Gulf Coast region. He noted that the office is coordinating its investigation with enforcement agencies in other states. Mr. Brauch mentioned that the office is also investigating a practice of "blocking" the bank accounts of consumers who use debit cards to pay for gasoline. This practice involves sequestering moneys in excess of the amount necessary to satisfy the customer's payment obligation.

Mr. Brauch acknowledged a concern that large retail dealers price gasoline below their wholesale cost as a loss leader to attract customers into their grocery or merchandise stores. According to Mr. Brauch, persons believe that this practice may drive smaller family-operated businesses out of the market and eventually destroy a competitive marketplace. Mr. Brauch described the provisions in Code chapter 551, which prohibits a retail dealer from offering merchandise at a sales price that is less than the price at which the dealer offers the same merchandise in another community if the purpose of the pricing decision is to destroy the business of a competitor or to establish a monopoly. He noted that it is difficult for a prosecutor to prove a violation of the statute absent clearly incriminating evidence. He also suggested that the chapter be amended to provide that a violation be subject to a civil rather than criminal penalty (see Code section 551.4), with a burden of proof being either a preponderance of the evidence or clear and convincing evidence rather than the current criminal standard of beyond a reasonable doubt.



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In conclusion, Mr. Brauch noted that the Federal Trade Commission has taken the position that laws that prohibit below-wholesale-cost pricing are generally anticompetitive and ultimately will lead to higher prices paid by consumers with no countervailing benefit.

Discussion. Committee members and Mr. Brauch briefly discussed a number of issues relating to below-wholesale-cost pricing practices. Co-chairperson Drake and Mr. Brauch discussed H.S.B. 282 filed during the 2005 legislative session which required that a retail dealer provide a minimum markup of gasoline. Mr. Brauch expressed a concern about interfering in the marketplace by imposing government-ordered pricing.

V. Department of Agriculture and Land Stewardship.

Testimony. The Committee considered testimony by Mr. Ron Rowland, Director, Consumer Protection and Animal Health Division, Iowa Department of Agriculture and Land Stewardship (DALs). Mr. Rowland stated that the DALs Weights and Measures Bureau is responsible for inspecting the more than 34,000 licensed motor vehicle pump meters in 2,665 locations in the state. According to Mr. Rowland, the bureau's inspectors also review promotional labels required to be affixed to pumps which dispense renewable fuel (see Code section 214A.16). In addition, inspectors confirm that the advertised price posted on a service station's street sign is consistent with the sales price for the motor fuel dispensed at the pump.

Mr. Rowland explained that DALs maintains a small fuel quality testing program that collects approximately 50 samples a year, either as a result of a consumer's complaint or an inspector's referral. He stated that the samples are tested by a laboratory operated by the State of Missouri. According to Mr. Rowland, DALs has prosecuted two cases in which fuel quality was an issue.

Mr. Rowland stated that DALs has not taken a position regarding the merits of legislation which prohibits below-cost pricing for the sale of motor fuel. He noted that an agency charged with enforcing such legislation must have adequate financial and staff resources and that the language in the legislation must establish a workable system for determining compliance. In discussing H.S.B. 282, Mr. Rowland recommended that the legislation be improved. First, he noted that the bill increases the licensing fee from \$9 to \$19, but does not correspondingly increase the fee for early payment from \$4.50 to \$14.50 (see Code section 214.3). Mr. Rowland stated that the current number of DALs staff is inadequate to enforce the bill's provisions. He also addressed enforcement issues, including DALs access to business records and the imposition of civil penalties. Mr. Rowland stated that locking motor fuel pumps, and thereby preventing the dispensing of motor fuel, may not be a practical deterrent. Finally, he stated that any legislation should include a delayed effective date to allow time for the enforcing agency to prepare for its new duties.

Discussion. Committee members and Mr. Rowland briefly discussed proposed auditing provisions in motor fuel pricing legislation. Mr. Rowland suggested that statutory provisions authorizing DALs to inspect the business records of grain dealers and warehouse operators might be used as a model (see Code chapters 203 and 203C).



VI. Hy-Vee, Inc.

Testimony. The Committee considered testimony by Mr. Thomas Watson, Assistant Vice President, Petroleum Marketing, Hy-Vee, Inc. (Hy-Vee). Mr. Watson stated that Hy-Vee operates 29 retail outlets in Iowa. He noted that competition is a fundamental component of the free enterprise system and that legislation regulating the pricing of motor fuel would create higher prices which would be detrimental to consumers.

Discussion. Committee members and Mr. Watson discussed a number of issues. In response to a question by Co-chairperson Kibbie, Mr. Watson noted that Hy-Vee prices gasoline at a 3 cent discount as a loss leader to attract customers into its grocery stores. In response to a question by Co-chairperson Behn, Mr. Watson acknowledged that motor fuel is sometimes sold below its wholesale cost in order to increase purchases of other products. In response to a question by Senator Kettering, Mr. Watson noted that Hy-Vee offers a standard discount of up to 3 cents per gallon of gasoline, which is accomplished by the issuance of coupons to customers who purchase other products in its grocery stores.

VII. Dyno Oil Company, Inc.

The Committee considered testimony by Mr. Mark W. Nelson, President of Dyno Oil Company, Inc. Mr. Nelson stated that he owns nine convenience stores, employing over 80 persons and serving six counties in northwest Iowa. He stated that large retail businesses, such as Wal-Mart Stores, Inc., in conjunction with Murphy Oil Corporation, and Hy-Vee, Inc., in conjunction with Fleet Wholesale Supply Company, Inc. (dba Mills Fleet Farm), regularly price their gasoline for sale at a loss. He stated that the effect of this policy is to decrease competition. Mr. Nelson stated that as consequence of market consolidation and predatory pricing practices by "big box" retail businesses, small independent retail dealers will be less likely to acquire wholesale supplies of motor fuel. He disputed any assertion that legislation prohibiting below-wholesale-cost pricing will be detrimental to consumers. Mr. Nelson summarized the results of two studies relating to the impact of these practices on independent businesses. Mr. Nelson also emphasized the need of the state to provide incentives to petroleum marketers to sell E-85 gasoline.

VIII. Iowa Grocery Industry Association.

The Committee considered testimony by Mr. James B. West, Legislative Counsel, Iowa Grocery Industry Association (IGIA). Mr. West stated that the IGIA has 1,100 members, including supermarket chains, independent grocery stores and supermarkets, mass merchandisers, convenience stores, wholesalers, distributors, suppliers, brokers, bottlers, and manufacturers. He noted that members of IGIA sell motor fuel and use many merchandising techniques in order to attract customers, including the advertising of special price discounts. He explained that because the grocery industry is highly competitive at all levels, quality groceries and products are delivered to Iowans in the greatest variety and at the lowest prices possible. Mr. West stated that IGIA members strongly support a market-driven free enterprise system. He opined that protecting individual competitors from the forces of competition in the marketplace will ultimately result in higher prices for consumers and the loss of the benefits derived from competition. Mr. West also noted that if a rural family business is to survive, it must have patronage from the members of its



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community. He stated that although it is sometimes easy to become nostalgic for the past, free enterprise remains the most rational economic system available.

IX. American Petroleum Institute.

Testimony. The Committee considered testimony by Mr. David Smitherman, representing the American Petroleum Institute. Mr. Smitherman stated that, historically, the institute has opposed legislation that interferes with the free marketplace. He noted that adequate protection against unfair or illegal marketing practices currently exists at the state and federal levels, and constraints imposed upon competition would ultimately result in higher prices for consumers. He stated that it was his understanding that legislation has been introduced in Wisconsin that would repeal its minimum pricing law and that the Governor of Minnesota has expressed a desire to repeal that state's minimum pricing statute.

Discussion. Committee members and Mr. Smitherman discussed the causes of high motor fuel prices. Mr. Smitherman stated that there is a lack of refining capacity in the United States. He also noted that costs associated with complying with environmental regulations affect wholesale pricing. Mr. Smitherman emphasized the nation's need to develop a comprehensive energy policy which would allow more drilling in coastal regions of the country. In response to a comment by Representative Kressig, Mr. Smitherman responded by stating that the United States should increase its domestic production of crude oil. He also noted that there is no excess supply of crude oil in the world market. In response to a question by Representative Upmeyer, Mr. Smitherman discussed the use of red diesel fuel pursuant to a temporary waiver granted by the federal Environmental Protection Agency in response to shortages in diesel fuel caused by recent natural disasters.

X. Casey's General Stores, Inc.

Testimony. The Committee considered testimony by Mr. Douglas M. Beech, Legal Counsel representing Casey's General Stores, Inc. (Casey's). Mr. Beech stated that Casey's is an Iowa-based company which was founded and is headquartered in Ankeny, Iowa. According to Mr. Beech, Casey's has 353 convenience stores located in almost every county of the state. He noted that every store offers motor fuel for sale, including E-10 gasoline.

Mr. Beech stated that Casey's opposes legislation regulating the pricing of motor fuel, such as H.S.B. 282. He stated that such legislation may have unintended consequences that are detrimental to both consumers and motor fuel marketers. Mr. Beech predicted that if enacted the legislation would artificially increase the wholesale price of motor fuel by 3 percent and the retail price of motor fuel by another 8 percent. Mr. Beech provided a number of examples of how the legislation would affect local markets in the state.

Discussion. Committee members, including Co-chairperson Kibbie and Senator Beall, discussed prices for motor fuel in different regions of the state. Mr. Beech stated that pricing decisions are often based on a number of factors unique to a particular region of the state.



XI. Petroleum Marketers and Convenience Stores of Iowa.

Testimony. The Committee considered testimony by Mr. Jim Mulgrew, CEO of Mulgrew Oil Company and Chairman of Petroleum Marketers and Convenience Stores of Iowa (PMCSI). Mr. Mulgrew stated that Mulgrew Oil Company, a family-owned business founded in 1893, owns and operates three stores in the area around Dubuque, Iowa, and supplies approximately 100 more retail dealers in Iowa, Illinois, and Wisconsin. He noted that approximately 70 percent of PMCSI's membership is composed of small family farm operations, which often are the economic backbone of rural communities.

Mr. Mulgrew stated that large retail businesses discount the sale of motor fuel to reward customers or for use as a loss leader to attract customers away from traditionally small stores. He noted that over the last five years, Iowa has ranked among the five states with the lowest retail fuel profit margins, which is one reason why small retail dealers are failing to survive. He stated that Mulgrew Oil Company has sold most of its retail outlets and concentrates on its wholesale distribution business. He stated that in the long run, consumers are best served by having more than a few large motor fuel dealers survive.

Discussion. Committee members briefly discussed several issues with Mr. Mulgrew. Co-chairperson Kibbie invited Mr. Mulgrew to reexamine legislative approaches for the next session of the General Assembly, including the provisions of H.S.B. 282. Senator Beall thanked Mr. Mulgrew for "putting a face" on the issue.

XII. Committee Action.

Committee members discussed a number of issues raised by persons presenting testimony. Co-chairperson Kibbie noted an increasing demand for renewable fuel such as ethanol blended gasoline and biodiesel. Members noted that they would continue to consider motor fuel pricing practices during the next legislative session and that several standing committees have jurisdiction to consider further action. The Committee did not make a formal recommendation to the Legislative Council or General Assembly.

XIII. Materials Filed With the Legislative Services Agency.

The materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the "Additional Information" link on the Committee's Internet page:

<http://www.legis.state.ia.us/aspx/Committees/Committee.aspx?id=74>



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1. Final Agenda submitted by Ms. Susan Crowley.
2. Proposed Committee Rules submitted by Ms. Crowley.
3. Memorandum "Background Information" submitted by Ms. Crowley.
4. Written testimony and exhibits submitted by Ms. Dawn Carlson.
5. Written testimony submitted by Mr. William Brauch.
6. Written testimony submitted by Mr. Ron Rowland.
7. Written testimony submitted by Mr. Thomas Watson.
8. Written testimony and exhibits submitted by Mr. Mark W. Nelson.
9. Written testimony submitted by Mr. James B. West.
10. Newspaper article submitted by Mr. West: "Another Reason to Love Wal-Mart" published in the Wall Street Journal (06/29/05).
11. Written testimony submitted by Mr. David Smitherman.
12. Written testimony submitted by Mr. Douglas M. Beech.
13. Written testimony submitted by Mr. Jim Mulgrew.

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